

This letter describes the Retailers' Occupation Tax or Service Occupation Tax liability of a company that sells merchandise and services to entities providing workers compensation benefits. See 86 Ill. Adm. Code 130.310. (This is a GIL).

August 1, 2002

Dear Xxxxx:

This letter is in response to your letter dated April 25, 2002. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

On behalf of our client (the 'CLIENT'), FIRM respectfully requests your guidance on the scope and application of the retailers' occupation tax (the 'sales tax') as promulgated by 35 ILL. COMP. STAT. 120/2. More specifically, this is a request for a ruling from the Illinois Department of Revenue (the 'Department') to determine which party is responsible for paying sales tax on certain products and services sold by our CLIENT, paid for by Workers' Compensation Companies, and delivered to workers' compensation patients. With respect to the guidance sought herein, CLIENT is not currently under audit by the Department and does not presently owe any outstanding tax to Illinois.

Background

CLIENT is in the business of providing home delivery of medications, medical equipment, supplies, and services (hereinafter 'products and services') to workers' compensation patients in Illinois. Although workers' compensation patients located in Illinois use and enjoy benefits of CLIENT's products and services, it is ultimately Workers' Compensation Companies that pay for CLIENT's products and services.

As you are aware, workers' compensation is a state-regulated insurance program that pays medical bills and replaces some lost wages for employees who are injured at work or who have work-related diseases or illnesses. Many Workers' Compensation Companies that contract with CLIENT are located in your state, yet some are located outside of Illinois. Although Workers' Compensation Companies may be privately owned or administered by Illinois, all Workers' Compensation Companies are required to abide by the guidelines set forth under Chapter 820, Article 305 of the Illinois Employment

Injuries Workers' Compensation Act. When an injured worker is deemed eligible for workers' compensation benefits, Workers' Compensation Companies are responsible for paying eligible medical bills on behalf of injured workers.

In an effort to minimize costs associated with medical bills stemming from an employee injured at work, Workers' Compensation Companies contract with CLIENT to arrange for direct shipment of products and services to workers' compensation patients in Illinois. Pursuant to contractual agreements with Workers' Compensation Companies, CLIENT is provided information about workers' compensation patients to arrange for delivery of its products and services. CLIENT is contractually unable to invoice workers' compensation patients for its products and services. Instead, CLIENT receives payment directly from Workers' Compensation Companies for products and services provided to workers' compensation patients by CLIENT; therefore, no meaningful relationship exists between CLIENT and workers' compensation patients.

Neither CLIENT nor Workers' Compensation Companies invoice injured workers for any of the products or services provided to injured workers by CLIENT. In fact, the injured workers, who are typically seriously ill or injured homebound individuals, are usually unaware of the cost of the products and services received due to the structure of reimbursement between the Workers Compensation Companies and CLIENT.

CLIENT has sales and use tax nexus with Illinois, is registered to collect sales and use taxes and wishes to satisfy its sales and use tax responsibilities with Illinois. Due to CLIENT's unique relationship with Workers' Compensation Companies and CLIENT's inability to directly invoice injured workers for its products and services, CLIENT respectfully requests that the following issues are addressed:

Issues

1. Since Workers' Compensation Companies are statutorily required to pay all costs arising out of a work related injury, are Workers' Compensation Companies also responsible for paying sales or use taxes due on taxable products and services?
2. Are the Workers' Compensation Companies or the injured workers considered the end user of taxable products and services sold by CLIENT?
3. What is the tax base for taxable products and services sold by CLIENT? (amounts actually received by CLIENT from Workers' Compensation Companies or the amount CLIENT lists as its retail selling price?)
4. Is there a distinction in the sales tax treatment of payments received by CLIENT from state administered Workers' Compensation Companies versus privately owned Workers' Compensation Companies? (i.e. does Illinois provide an exemption from sales and use tax for payments received from state administered Workers' Compensation companies?)
5. If Workers' Compensation Companies are not responsible for paying sales tax on taxable products and services (*see Issue One*), who is responsible for paying sales and use tax on taxable products and services?

6. Who is responsible for collecting and remitting sales and use tax on taxable products and services?
7. If CLIENT is responsible for collecting and remitting sales and/or use tax due on taxable products and services, do Workers' Compensation Companies have a duty to reimburse CLIENT for this tax and does CLIENT have the statutory authority to invoice and collect this tax from Workers' Compensation Companies?
8. If Workers' Compensation Companies are located outside of Illinois, what impact, if any, does this fact have on the answers to issues one through seven?
9. Would the answers to issues one through seven change if CLIENT's products and services are reimbursed by Medicare and/or Medicaid?

After you review the foregoing letter, please call me to discuss any questions or comments you may have.

DEPARTMENT'S RESPONSE:

Based upon the information provided in your letter and our limited understanding of how workers' compensation benefits are administered in Illinois, we believe that the entity purchasing the medications, medical equipment, and supplies for use by workers' compensation patients located in Illinois would generally be considered the user of those items. As we understand the workers' compensation process, the entity making these purchases may be either a self-insured employer or a third party (such as an insurance company). See 820 ILCS 305/4 (2000 State Bar Edition). We do not understand what you mean when you refer to "state administered workers compensation companies."

Illinois retailers making sales of tangible personal property to such employers or insurance companies would incur Retailers' Occupation Tax liability on those sales and would be required to collect Use Tax from the purchasers. The purchasers incur a Use Tax liability on those purchases and are required to remit the tax to the retailer (or directly to the Department if the retailer is not registered to collect Illinois tax). Retailers are allowed to retain the amount collected as Use Tax from purchasers as long as they properly file their returns and remit their Retailers' Occupation Tax liability to the Department on those sales.

Please note that the State provides a lower rate of State tax (1%) on food, drugs, and medical appliances. See 86 Ill. Adm. Code 310. The imposition of the various sales tax related local taxes in Illinois are triggered when 'selling' occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. Although 86 Ill. Adm. Code 270.115 deals with the municipal Home-Rule taxes, the principles outlined in this regulation apply to all local taxes administered by the Department.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see the Department's regulations, 86 Ill. Adm. Code 140.101 through 140.109, regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See Ill. Adm. Code 140.108.

Organizations that qualify as exclusively religious, charitable, or educational can apply to the Illinois Department of Revenue to obtain tax exemption identification numbers ("E" numbers). These numbers establish that the Department recognizes said organizations as exempt from incurring Use Tax or Service Use Tax when purchasing tangible personal property in furtherance of their

organizational purposes. See 86 Ill. Adm. Code 130.2007. The Department has issued "E" numbers to certain hospitals. Companies selling tangible personal property to these hospitals or other exempt organizations must be provided with an "E" number for sales to such organizations to be tax exempt. The entities making the purchases described in your letter would not normally qualify as exempt organizations.

When entities make retail sales to Medicare and Medicaid, such sales are generally exempt from tax as sales to a government body so long as the exemption is properly documented. See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portion of bills not covered by Medicare and Medicaid that are paid by individuals or private insurance companies. This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.